Supreme Court, U.S.
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No. 92-621

In The

Supreme Court of the United States

October Term, 1992

DONALD NEAL RAKE, *et al.*,

Petitioners,

vs.

WILLIAM J. WADE, Trustee,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF FOR RESPONDENT

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EDITOR'S NOTE

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RULE 21.1 STATEMENT

Willlam J. Wade is Trustee of Mid-State Trust II, a Delaware Business Trust. The beneficiary of the trust is Mid-State Homes, Inc., a Florida Corporation, which is a subsidiary of Mid-State Holdings Corporation, a Delaware Corporation, wholly owned by Walter Industries, Inc.. Walter Industries, Inc. is a Delaware Corporation and owns also all of the stock of the subsidiary companies, to wit: Best Insurors, Inc., Cardem Insurance Co., Ltd., Coast to Coast Advertising, Inc., Computer Holdings Corporation, Dixie Building Supplies, Inc., Hamer Holdings Corporation, Homes Holdings Corporation (which has as a subsidiary Jim Walter Homes, Inc.), JW Aluminum Company, Jim Walter Resources, Inc., JW Window Components, Inc., J.W.I. Holdings Corporation, Land Holdings Corporation, Railroad Holdings Corporation, Sloss Industries Corporation, Southern Precision Corporation, United Land Corporation, United States Pipe and Foundry Company, and Vestal Manufacturing Company.

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STATEMENT OF THE CASE

The straight-forward facts in this case involve the statutory right of an over-secured mortgagee to recover interest upon arrearages (including past due payments, late charges, court costs, and attorney fees and contractual advancements) in a chapter 13 plan where the mortgage constitutes a first lien upon the principal residence of the Debtor. As such, this right is not dependent upon contractual provisions for interest upon defaulted arrearages but upon the clear intent of Congress and the express, unambiguous provisions of the Bankruptcy Code. Contrary to Petitioner's contention on page 4 of their brief, the promissory notes do not constitute a pre-computed consumer loan under the Uniform Consumer Credit Code. The reason for this is discussed in detail *infra*.

Examination of four Bankruptcy Code sections is mandated: §§ 506(b), 1322(b)2, 1322(b)5, and 1325(a)(5)B)(ii).

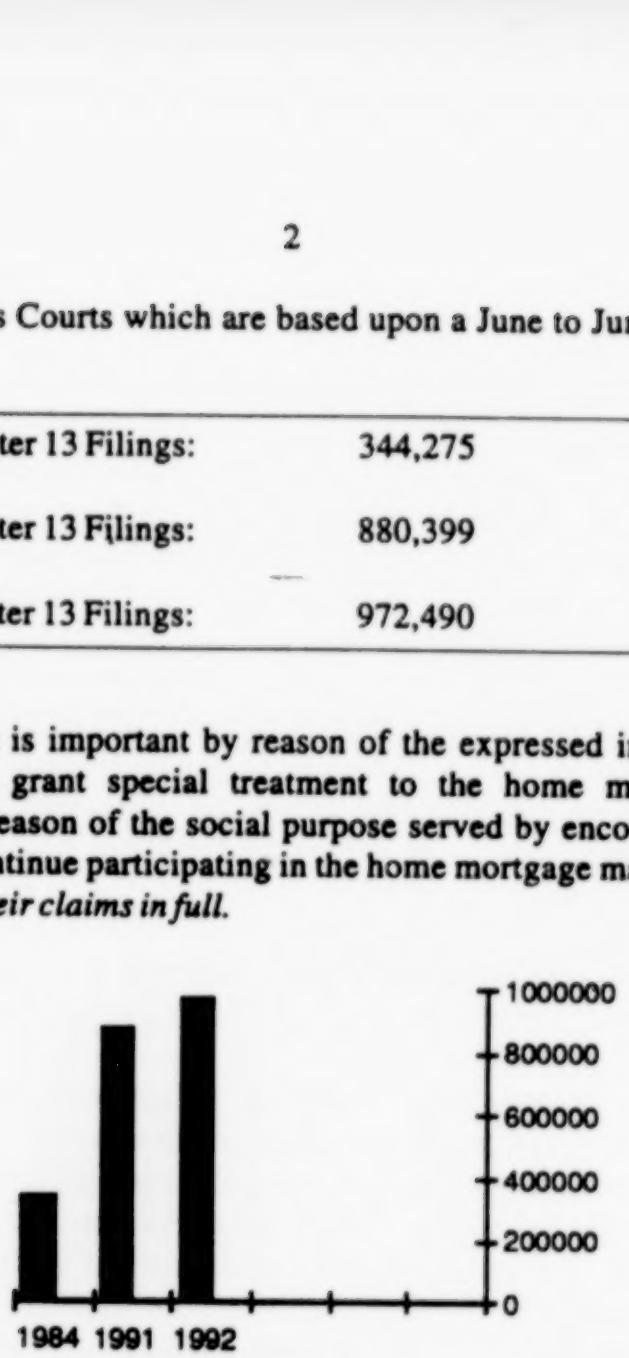
This examination is crucial to the national economy on two fronts: First, the home lending industry is on its knees as a result of many economic factors, some of which resulted from injudicious loans, over-evaluation of property values, corrupt lending practices, to name some involving the fault of the industry. Other reasons not the fault of the industry are the normal fall in real estate values, the sad times which have resulted in a large number of foreclosures, and the wild fluctuation of interest rates. Second, is the large number of chapter 13 bankruptcies that have involved the varying and inconsistent treatment of home mortgages by the courts.

The following chart and graph indicate the huge increase of chapter 13 filings since 1984, according to the statistics compiled by the Bankruptcy Division of the Administrative Office of the

United States Courts which are based upon a June to June fiscal year.

1984 Chapter 13 Filings:	344,275
1991 Chapter 13 Filings:	880,399
1992 Chapter 13 Filings:	972,490

This case is important by reason of the expressed intent of Congress to grant special treatment to the home mortgage industry by reason of the social purpose served by encouraging lenders to continue participating in the home mortgage market *by preserving their claims in full.*



By reason of the fact the Bankruptcy Code is not a model of clarity, early attacks on the rights of mortgagees resulted in a myriad of conflicting decisions by the courts, such as denying interest upon arrearages where the mortgagee is over-secured, bifurcating the allowed claim on under-secured mortgagees such that 100 per cent of the secured portion is paid under the plan, but only cents on the dollar is paid to what was denominated the unsecured claim. In other cases, interest was allowed at the

contract rate, at the market rate, at the treasury rate, or not at all.

The confusion is so profound, that at the present time in the Western District of Oklahoma one District Judge rules that bifurcation is proper in a chapter 13 context on a home mortgage where another District Judge down the hall rules that it is not proper.

Confusion is rift amongst the courts on these issues before it, and the violence to the home lending market by reason of this confusion is in direct violation of the intent of Congress and the express terms of the Code.

SUMMARY OF THE ARGUMENT

It is clear from the legislative History that through compromise between the House and Senate, while some secured claims were subject to modification, those secured claims which were first liens upon the principal residence of the Debtor were not to be modified; however, Congress did allow modification of those secured claims to the extent of the automatic stay of foreclosure under 11 U.S.C. § 362 and the modification of the right to foreclosure by deacceleration of the debt, and the forcing of the forebearance of timely payment of arrearages under 11 U.S.C. § 1322(b)(5) over a period of thirty-six or sixty months.

In lieu of being allowed the right to foreclose and to receive the accelerated amount of the defaulted debt, Congress intended that secured claims under chapter 13 be treated identically with secured claims under chapter 11. The time value of deferred payments was recognized as being equal in both chapter 13 and 11, but the courts have divided upon their interpretation of the Code.

While saying in one breath that 11 U.S.C. § 1322(b)(2) prohibits modification of home mortgages by the denial of

granting the time value of money by interest upon the unpaid arrearages, the courts find little difficulty in rationalizing that under 11 U.S.C. § 506(a) bifurcating such a claim into an secured claim and an unsecured claim is not a modification of the mortgage.

There is absolutely no justification in the holding of the Circuits to the effect that 11 U.S.C. § 1325(a)(5)(B)(ii) has no application to home mortgages.

There is nothing in the Code that provides that cure of the default is a function of state law rather than bankruptcy law. There is nothing in the Code that provides that cure in a chapter 13 context is governed by applicable non-bankruptcy law.

The Bankruptcy Code pre-empts state law with reference to the treatment of home mortgages. The claim that the Uniform Consumer Credit Code applies to the subject mortgages and promissory notes is totally without statutory or case law foundation. This Court should consider the issues in this action in conjunction with the pending matter relating to bifurcation of home mortgages for the reason the issues are inter-locked. This Court should affirm the holding of the Tenth Circuit in this case.

ARGUMENT

I.

THE INTENT OF CONGRESS IS TO PROVIDE SPECIAL TREATMENT TO HOLDERS OF HOME MORTGAGES.

Insofar as § 506(b) is concerned, need for resort to legislative intent is minimal. This Court in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S. Ct. 1026, 103 L. Ed. 2d. 290

(1989) dealt with a Chapter 11 plan involving a non-consensual lien. It was expressed that resort to legislative intent was not necessary for the reason the statute was sufficiently clear by its terms as to entitle the holder of an over-secured claim to post petition interest, "and in addition gives one having a secured claim created pursuant to an agreement the right to reasonable fees, costs, and charges provided for in that agreement. Recovery of post petition interest is *unqualified.* Recovery of fees, costs, and charges, however, is allowed only if they are reasonable and *provided for in the agreement* under which the claim arose. Therefore, in the absence of an agreement, post petition interest is the only added recovery available." 109 S. Ct. at 1030. The Court observed that whether or not Congress took notice of pre-Code practice, yet it expressed this statute with sufficent clarity that resort to legislative history and to pre-Code practice was not necessary.

Examination of legislative intent is pertinent insofar as § 1322 is concerned. When the House considered the proposed bill as reported from the Committee, § 1322(b) provided for the modification of the rights of all secured and unsecured claims. Paragraph 5 of that section provided for the curing of defaults of long-term debt on which the last scheduled payment of the debt came due after the last payment under the plan. H. Rep. No. 95-595, p. 429.

The present § 1322(b)2 represents a compromise between the House version and the Senate version. The Senate proposed the subsection read:

> (2) modify the rights of holders of secured claims (other than claims wholly secured by mortgages on real property) or holders of unsecured claims;

The final version was explained as follows:

> Section 1322(b)2 of the House amendment represents a compromise agreement between similar provisions in the House bill and Senate Amendment. Under the House amendment, the plan may modify the rights of holders of secured claims other than a claim secured by a security interest in real property that is the debtor's principal residence. It is intended that a claim secured by the debtor's principal residence may be treated with under section 1322(b)5 of the House amendment.

See Cong. Rec. (Sept. 28,1978) p. H 11107. Reprinted in 1978 U.S.C.C.A.N. p. 6550.

Section 1325(a)(5)(B)(ii) also was a compromise between the House and Senate. It was intended that unless a secured creditor accepted the plan, the intent was expressed thus:

> Unless the secured creditor accepts the plan, the plan must provide that the secured creditor retain the lien securing the creditor's allowed secured claim in addition to receiving value, as of the effective date of the plan . . . not less than the allowed amount of the claim.

Cong. Rec. (Sept. 28, 1978) p. H 11107. Reprinted 1978 U.S.C.C.A.N. p. 6550.

The most lucid expression of intent to allow interest upon arrearages was later stated by the Senate:

> Section 1325 (a) (5) (B) of the House amendment modifies the House Bill and Senate amendment to significantly protect secured creditors in chapter 13. Unless the

> secured creditor accepts the plan, the plan must provide that the secured creditor retain the lien securing the creditor's allowed secured claim in addition to receiving value as of the effective date of the plan of property to be distributed under the plan on account of the claim not less than the allowed amount of the claim. To this extent, a secured creditor in a case under chapter 13 is treated identically with a secured creditor under § 1111(b)(1) of the House amendment except that the secured creditor in a case under chapter 13 may receive any property of a value as of the effective date of the plan equal to the allowed amount of the creditor's secured claim rather than being restricted to receiving deferred cash payments . . . To the extent the deferred payments exceed the value of the allowed claim and the debtor subsequently defaults, the lien will not secure unaccrued interest represented in such deferred payments.

Cong. Rec. (October 5, 1978) p. S. 34009.

We submit there can be no clearer expression of the intent of Congress to allow interest upon deferred payments of arrearages in a chapter 13 case.

As of the time of preparation of this brief, proposals of S. 1985 which was intended to clarify that Congress did not intend any modification of home mortgages (as regards lien stripping) passed the Senate on June 17, 1992 by a vote of 97-0. H.R. 5321 is presently pending in the House. That bill as passed by the Senate provides:

> Section 1322(b)(2) of Title 11, United States

> Code, is amended by striking "claims" and inserting "claims, but the plan may not modify a claim holding a primary or a junior security interest in real property or a manufactured home ... that is the debtor's principal residence, except that the plan may modify the claim of a person holding such a junior security interest that was undersecured at the time the interest attached to the extent that the interest remains undersecured."

Any examination of the intent of Congress must include the authority of *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 55 S. Ct. 854, 79 L. Ed. 1593 (1935). As was repeated in *Dewsnup v. Timm*, __U.S.__, 112 S. Ct. 773 (1992), Congress, when it writes a new bankruptcy act, it does not do so upon a clean slate. Also, it was held " ... that liens pass through bankruptcy unaffected." 112 S. Ct. at 778.

Radford established that whenever Congress exercises its bankruptcy power, it must do so subject to the Fifth Amendment. 295 U.S. at 589. That case examined the early historical treatment of mortgages, and to our knowledge first used the word "cure" within the context of the development of the equitable concept of redemption, saying "... the statutory command that the mortgagor should not lose his property on default had always rested on the assumption that the mortgagee would be compensated for the default by a later payment, with interest, of the debt for which the security was given; and the protection afforded the mortgagor was, in effect, the granting of a stay. No instance has been found, except under the Frazier-Lemke Act, of either a statute or decision compelling the mortgagee to relinquish the property to the mortgagor free of the lien unless the debt was paid in full." 295 U.S at 579.

Again, the matter of interest was addressed as follows:

> This right of the mortgagee to insist upon full payment before giving up his security has been deemed of the essence of a mortgage ... But practically always the measures adopted for the mortgagor's relief, including moratorium legislation enacted by the several states during the present depression resulted primarily in a stay; and the relief afforded rested, as theretofore, upon the assumption that no substantive right of the mortgagee was being impaired, since payment in full of the debt with interest would fully compensate him.

295 U.S. at 580.

It was, therefore, historical that no bankruptcy act had ever undertaken to supply the debtor with capital with which to reorganize.

The term "modify" was found in *Radford* in the context that "No bankruptcy act had undertaken to modify in the interest of either the debtor or other credltors any substantive right of the holder of a mortgage valid under federal law. 295 U.S. at 583.

Radford then discussed the fundamental rights of a mortgagee, such as the right to retain its lien until full payment, and the rights to rents and profits, the control over the property during default, and then held the clincher:

> For the Fifth Amendment commands that, however great the Nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest requires, and permits, then taking of property of individual mortgagees in order to preserve the necessities of individual

> mortgagors, resort must be had to proceedings in eminent domain so that, through taxation, the burden of the relief afforded to the public interest may be borne by the public.

295 U.S. at 602.

We believe that *Radford* clearly provides the slate Congress was writing upon such that depriving a mortgagee of the fundamental right to the time value of the full payment of his mortgage debt includes the payment of interest for the forbearance thereof,

II.

NOT ALLOWING INTEREST UPON ARREARAGES IS CONTRARY TO THE EXPRESS PROVISIONS OF THE CODE.

As is most often the case, chapter 13 filings are usually races to the Courthouse in order to forestall a pending foreclosure. Usually, the filing presages the day of the sheriff's sale. The effect of the fillng under 11 U.S.C. § 362 is to modify the rights of the mortgagee by denying him his right to foreclose, his right to obtain title to the property, to later sell it or otherwise dispose of it, and to obtain a deficiency judgment. This is the permissible modification Congress intended under § 1322(b)5 which *in esse* is a "de-acceleration" of the event of default. The Debtor's plan then proposes to pay the regular payments over the life of the plan and at the same time repay the arrearages which often include court costs, attorney fees, and any advancements such as insurance, taxes, and abstracting expense. The payment of the arrearages has been accurately described by *In re Thomas*, 115 B. R. 305 (Bankr. E. D. Okla. 1990) this way:

> Since Jim Walter Homes is entitled to the

> immediate payment of its defaulted amounts and yet the Debtors intend to delay this payment over a three to five year term of a Chapter 13 Plan, the creditor cannot be expected to endure this delay in payment without additional compensation. The consideration for the interest rate provided under the original note and mortgage was the initial delay in payment caused by the loaning of the funds over the term of the note. Now, the Debtors are requesting a further delay, and for this, we find that Jim Walter Homes is entitled to interest over the term of the Plan for the payments on arrearages.

Since the memory of man runneth not to the contrary, the legal meaning of "Interest" has been defined as the compensation for the use or forbearance or detention of money. "I don't believe in princerple, But oh I du in interest." *The Bigelow Papers, Series II.*

It goes without saying the loan of money is a bargain, usually at market rates, whereby a consideration is paid for the forbearance of money over the life of the loan. The interference with this bargain is not only the modification of the right of foreclosure and acceleration of the mortgage balance but the setting of a later date for the receipt of the defaulted amounts. In setting an interest upon that "new loan" the court is continuing the benefit of the bargain to the mortgagee (although at often a lower rate than originally agreed upon).

Such was the analysis in *In re Colegrove*, 771 F.2d 119 (6th Cir. 1985). The trial court opined that allowing interest upon the arrearage was to modify the mortgage contrary to § 1322. The Sixth Circuit viewed the refusal of interest as preventing the creditor the realization of the full *present value* of the amount

owed. The Circuit viewed the allowing of interest as a mere incident to the "cure" of § 1322(b)5. Further, the Circuit viewed §§ 506(b) and 1325(a) together, noting that the former section provides for interest upon an "allowed secured claim" where the value of the security is greater than the claim; the latter directs the bankruptcy court to confirm a plan only where the creditor will receive the *present value* of the amount due him. Also, the Circuit interpreted the statutes as "making a new loan to the debtor in the amount of the current value of the collateral . . . and such creditor was entitled to interest at the current market value for similar loans at the time. While concluding that current market rate was to be applied to the delay in payments, the Circuit acknowledged that many courts applied the contract rate the parties agreed to as a fair return to the creditor for the repayment of money over a period of time. 771 F.2d at 123.

The cases to the contrary are *In re Laguna*, 944 F.2d 542 (9th Cir. 1991); *Landmark Financial Services v. Hall*, 918 F.2d 1150 (4th Cir. 1990); *Appeal of Capps*, 836 F.2d 773 (3rd Cir. 1987); *In re Terry*, 780 F.2d 894 (11th Cir. 1985) (jointly referred to hereinafter as the "*Terry* line").

What is mutual in all those case is there was no provision for post-default interest in the mortgages. In *Terry* and *Capps*, *supra*, § 506 was not argued: neither was post *Ron Pair, supra*, and each one resolved the controversy by rejecting the "present value" arguments, contending §1325(a)(5)(B) *was not applicable to residential mortages*. All four cases involved over-secured mortgages. All the cases justified the refusal to allow interest upon the reason that to do so would be a modification in violation of §1322(b)2. *Terry*, in an attempt at intellectual honesty, stated "there is no right or wrong" to the argument. 780 F.2d at 895. *Capps* went further in that it based refusal to apply §1325(a)(5)(B) upon the fact there was not a prerequisite modification of the mortgage contract. That court further concluded that §1325 was

not intended to benefit home mortgages. Where that sweeping construction is justified is a mystery.

Both *Landmark* and *Laguna, supra,* were post *Ron Pair* and involved the argument that § 506(b) called for the application of interest upon the arrearages in a Chapter 13 proceeding. *Capps* held a cure under § 1322(b)5 is not a modification of the mortgagee's rights, that § 1325 present value test is irrelevant since the mortgagee's rights have not been modified, and that § 506(b) is inapplicable in the context of mortgage cures. In excusing the application of § 506(b) the *Landmark* court said:

> The valuation of the claim or the collateral is simply immaterial when the original agreement is reinstated and the debtor elects to make all the payments called for by the agreement. The mortgagee receives only the interest and other charges to which it is entitled under the agreement and applicable non bankruptcy law.

918 F.2d at 1155.

Laguna echoed *Landmark* in holding that the present value test of §1325 is irrelevant ". . . because the creditor's rights have not been modified. Whereas the cram down route compensates the secured creditor with the present value of his collateral, the cure route reinstates the initial agreement that is the basis of the claim regardless of the value of the collateral." 944 F.2d at 544.

It is difficult to understand what the Circuits were saying when they held that (i) calling a halt to foreclosure, reversing the acceleration of debt, and otherwise abridging all of the contractual rights attendant to default of a mortgage is not a "modification" such as to call into play the allowance of present value under § 1325 and (ii) that §1325 did not apply to home mortgages.

For too long the Bankruptcy Code has been construed under broad interpretations as courts performing equity without heed to the hoary doctrine that "equity follows the law." Such conduct is thankfully being brought to a halt by this Court's interpretation of the Bankruptcy Code in *Ron Pair* and *Dewsnup v. Timm*, __U. S. __, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992). Certainly one must hope that Justice Scalia's prayer in *Patterson* that ". . . the symbol of our profession may remain the scales, not the see-saw." 112 S. Ct. at 2251.

Wade v. Hannon, 968 F.2d 1036 (10th Cir. 1992) adopted the statutory construction standard expressed in *Patterson v. Shumate*, __U.S.__, 112 S. Ct. 2242 (1992) and followed the "plain language" of the statutes without strained resort to and trying to read into the statutes what Congress intended *vis-a-vis* what Congress clearly stated.

It was truly "attention to text" that persuaded the Tenth Circuit to rule as it did in *Wade*, That case acknowledged that truly "cure" under §1322(b)5 was a modification, notwithstanding the provisions of §1322(b)(2); the case acknowledged a plain reading of § 506(b) mandated paying interest to an over-secured claim even though there is an absence of a contractual provision; and the no modification rule certainly did not abrogate the mandate of paying interest.

For the application of § 506(b) to chapter 13 plans, one must realize that a secured claim by a home mortgagee is bicornuate in that under Bankruptcy Rule 3001(a) a claim shall conform substantially to the appropriate Official Form 10. That form provides for not only setting forth the balance due on the note and mortgage but the "amount of arrearage and other charges included in" the secured claim. Nowhere in the Code does it say that part of the claim under arrearages is to be excluded of interest and other charges, such as attorney fees, court costs, and advancements by the mortgagee.

The task before us is the conceptualization of the terms "cure" and "modify." Another court that resorted to "plain meaning" analysis is *Grubbs v. Houston First American Savings Association*, 718 F.2d 694 (5th Cir. 1983) held:

> The plain language of Section 1322(b)(5)'s preface, "notwithstanding paragraph (2)" indicates to us beyond peradventure that the cure of a default is, within the meaning of the statute, a modification of the rights of a residential mortgagee unless the cure is permitted by the terms of the mortgage. Congress provided generally in (b)(2) that the rights of these mortgagees could not be modified; then, in (b)(5), recognizing that curing a default was a modification of rights, provided a limited, rather than a broad, exception to (b)(2).

718 F.2d at 698-99.

Grubbs was overturned at rehearing, in *Grubbs v. Houston First Am. Sav. Ass'n*, 730 F.2d 236 (5th Cir. 1984), although the dissenting opinion continued to adhere to the "plain meaning" analysis.

It clear that §1322(b) (5)(ii) is a codification of the practice under former chapters XI and XIII whereby the injunctive power of § 2a(15) was utilized not to modify the rights of a creditor but to postpone his remedy upon reasonable and equitable conditions to aid a rehabilitation plan. *See United States Financial Corp. v. Brantley*, 6 B R 178, 190 (Bankr. N.D. Fla. 1980). Today, however, the effect of the bankruptcy petition is to enjoin foreclosure, and under chapter 13, a plan to allow the Debtor to repay the home mortgage arrearages over the life of the plan, while on the other hand, the home mortgage lender is entitled to full repayment of the

arrearages as well as full and timely payment of the subsequent payments due under the mortgage. Under the clear terms of §1322(b)(5) a cure is not available if the mortgage has matured under its terms, the provision for cure being restricted to those mortgages where the last scheduled payment is longer than the term of the plan.

A most excellent, recent article on this subject is — Paul D. Boynton, *Claims of Home Mortgage Lenders Against Chapter 13 Debtors: Should Full Payment Include Interest on Arrearages Repaid Over Time?*, 97 Commercial Law Journal 384 (Fall 1992).

III.

THE FULL AMOUNT OF THE HOME MORTGAGE CLAIM IS THE "ALLOWED" AMOUNT FOR DISTRIBUTION UNDER THE CHAPTER 13 PLAN.

In this case, the "allowed claim" of Wade is the balance due on the mortgage and the total of the arrearages, which include interest, attorney fees, late fees, insurance advanced, if any, and taxes advanced by the mortgagee as portions of the default.[1] Section 1325(a)(5)(ii) clearly reads "the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim." Clearly, the plan must provide for time-value interest on the "allowed amount of such claim." If it were otherwise, the claim would be less than the "allowed" amount.

The only "allowed" amount for a home mortgage lender permitted under the chapter 13 plan is its full claim, because

1. The note and mortgage provide for recovery upon default of all advancements made by the mortgagee such as insurance, claims, liens, taxes, insurance, assessments, attorney fees, and costs.

anything less would contravene the "no modification" rule of § 1322(b)(2). *A fortiorari*, as a matter of law, courts must allow the full amount of the home mortgage and full payment of arrearages under a chapter 13 plan.

If it were the intent of Congress to accord special treatment to home lenders, and if it is the intent of Congress (as expressed by the compromise amendment of § 1322(b)(2)) to prevent home lenders from having their mortgages modified (other than by the cure under § 1322(b)(5)), then *Colegrove* and *Wade* comply with that intent and are more consistent with the "no modification rule" than *Terry, Capps, Landmark*, and *Laguana*.

The *Terry* line of cases totally ignores the benefit of the bargain that transpired between the debtor and the lender. In each of the mortgages at bar the parties negotiated and agreed to an interest rate of 10% *per annum*. The *Terry* line of cases are based upon the incorrect permise that allowing interest on home mortgages arrearages, absent contractual language, would provide more, or perhaps something different, to a home mortgage lender than what it bargained for. However, as held in *Colegrove*, time-value interest on arrearages cured over the course of a chapter 13 plan merely facilitates the full benefit of the bargain for home mortgage lenders in that they receive the full value of their mortgages as they are amortized over a period of time. It is facile to suggest that home mortgage lenders who fail to bargain for a specific clause providing for time-value interest on arrearages cured over the course of a chapter 13 plan should not be granted such interest merely by virtue of a chapter 13 plan. The plan delays the acceleration rights and foreclosure rights of the mortgagee. Because this lapse of time diminishes the bargained-for mortgage amount, the time-value provision of § 1325(a)(5)(ii) merely makes home mortgage lenders whole by allowing courts to fashion an interest rate that provides a sum necessary to account for the diminishing value of money as the full amount of home mortgage

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arrearages are repaid over three or five years.

There is absolutely no congressional intent nor any statutory language extant that justifies the *Terry* line of cases to carve out a special exception to the plain language of § 1325(a)(5)(ii) simply because Congress chose to exclude home mortgages from modification.

An excellent analysis on this point is found in *In re Hall*, 117 B.R. 425 (Bankr. S.D. Ind. 1990). That court applied the plain language test to the analysis and found ". . . to the extent that an allowed secured claim is over secured, the holder shall be allowed post petition interest on such claim . . . Interest is allowed even if it is not provided for by agreement between the debtor and claimant." *Citing Ron Pair.* That case contrasted §§ 506(b) and 1325(a)(5) as follows:

> 4. These two sections address related but distinct concepts. Section 506(a) states, in simple terms, that the value of an allowed secured claim is no more than the value of the collateral securing it, any claim in excess being an unsecured claim. If the value of the collateral is more than the value of the claim, the entire claim is secured, and section 506(b) allows post petition interest on these over secured claims. The value of the secured claim may vary during the course of a bankruptcy because of such things as payments made on the claim and fluctuations in the value of the collateral. *See* 3 Collier on Bankruptcy para. 506.04[1]. If post petition interest is allowed, the value of the secured claim will increase as the interest accrues, up to the value of the

> collateral. Thus, section 506 provides a method for valuing an allowed secured claim at any given time during a bankruptcy case.
>
> [2] 5. In contrast, section 1325(a)(5) requires that the holder of each secured claim, regardless of whether the claim is over secured, receive the value of the secured claim as determined as of the effective date of the plan. In evaluating a Chapter 13 plan, section 506(b) determines the allowability of post petition interest in valuing an allowed secured claim as of the effective date of the plan, while section 1325(a)(5) requires the plan to provide the present value of that secured claim, usually through present value interest, as of that date. *See In re Corliss*, 43 B.R 176 (Bankr. D. Ore. 1984). In rough terms, the issue of post petition interest is governed by section 506(b) from the date of the petition to the effective date of the plan and by section 1325(a)(5) thereafter.

The Court further attacked the *Terry* line of cases *in seriatum* as follows:

> First, interpreting the present value requirement as a component of a permissible cure rather than a forbidden contract modification gives effect to all relevant sections of the Code. A contrary interpretation would put the provision that the holder of an allowed secured claim be given the present value of its claim in direct conflict with the provision forbidding modification of a home mortgage lender's contract rights. Allowing present value interest as a component of curing

a default rather than a modification of contract rights, however, harmonizes these provisions.

[4, 5] 10. Second, the primary purpose of section 1322(b)(2) is to provide stability in the residential long-term home financing industry and market. *See In re Brantley*, 6 B.R. 178, 189 (Bankr. N.D.Fla.1980). This section is intended to protect home mortgage lenders rather than home owners. *See In re Seidel*, 752 F.2d 1382, 1985 (9th Cir. 1985). Moreover, unlike in Chapter 11 a creditor may not propose a plan, *compare* 11 U.S.C. sections 1121 and 1321, so any limitations on plan provisions must be for the benefit of creditors rather than the debtor. Thus, section 1322(b)(2) protects the rights of home mortgage lenders from such contract modifications as lowering the amount of the monthly payments or the contractual interest rate, which would otherwise be permissible, *see In re Ramirez*, 62 B.R. 668 (Bankr. S.D. Cal. 1986). Interpreting this section to deprive home mortgage lenders of present value interest to which they would otherwise be entitled under section 1325(a)(5) would harm rather than protect these lenders, and thus would be contrary to the purpose of section 1322(b)(2). The Court will not interpret a Code provision in a way that is contrary to its purpose when there is an equally, indeed more, supportable interpretation that furthers its purpose.

[6] 11. Third, in a bankruptcy case, the cure rights of mortgagees, including home mortgage lenders, are governed by federal

rather that state law. *See In re Taddeo*, 685 F.2d 24, 28-29 (2nd Cir 1982) Courts that have disallowed present value interest have concluded that no interest be allowed unless the mortgagee would have a right to interest as part of the cure under its contract with the debtor or under state law. *See Capps*, 836 F.2d at 777 *Terry*, 780 F.2d at 897. However, federal bankruptcy law has already disrupted the mortgagee's cure rights by staying foreclosure, *see* 11 U.S.C. section 362(a), which the mortgagee could have resorted to in the absence of a speedy cure. (This indeed is a "modification" of the home mortgage lender's contract rights, but one that is not barred by section 1322(b)(2) because it is the Code itself, not the plan, that effects the modification.) Section 1322(b)(5) gives the debtor the right to cure defaults through a plan while the automatic stay prevents foreclosure, and section 1325(a)(5) defines what that cure must provide the mortgagee to make up for the loss of its right to speedy foreclosure. Thus, the fact that a mortgagee may have no state law or contract right to interest on arrearages does not affect its right to present value interest under the Code.

[7] 12. Fourth, the Court disagrees with the position that the present value requirement of section 1325(a)(5) is inapplicable when contract rights have not been modified under section 1322(b)(2). *See Capps*, 836 F.2d at 776-77; *In re Laguna*, 114 B.R 214 (9th Cir. BAP 1990). This position is based in part on the reasoning that since, in Chapter 11, only

members of an impaired class of secured creditors would be entitled to the present value of their claim in a cram down, *see* 11 US.C. section 1129(b)(2)(A)(i), and a plan may render claims unimpaired by reinstating the contract terms and curing defaults without the present value requirement, *see* 11 U.S.C. section 1124(2), therefore a Chapter 13 plan that cures a default without other-wise modifying a secured creditor's contractual rights is not subject to the present value requirement. This reasoning is flawed for three reasons. First, the concept of impaired or unimpaired classes is embedded in the complexities of Chapter 11 and has no application in other chapters. See 11 U.S.C. section 103(f) . Second, the prevailing authority is that to render a class unimpaired under section 1124, cure must be made on the effective date of the plan rather than over time through the plan, so a claim in fact would be impaired and the creditor entitled to present value interest if the Chapter 11 plan proposed cure over time. *See In re Jones*, 32 B.R 951 (Bankr. D. Utah 1983); 5 Collier on Bankruptcy para. 1124.03[4]. Third, this argument proves too much, since it would deprive not just home mortgage lenders but all secured creditors of present value interest on arrearages (unless the contract or state law allowed it), as long as the contract terms are not modified under section 1322(b)(2). This may have been the practice under the old Act, *see* 5 Collier on Bankruptcy para. 1322.09[4], but the plain provisions of the Code take precedence over past practice. The Chapter 13

present value provision of section 1325(a)(5) applies by its terms to all holders of secured claims, whether or not they would be impaired in Chapter 11, whether or not they are home mortgage lenders, and whether or not their contracts rights have been modified under section 1322(b)(2).

13. Because the Debtor now admits to the figures in Lomas's Proof of Claim, Lomas's Objection to Plan must be sustained. Because the Court concludes that Lomas is entitled to present value interest, the Debtor's Objection to Claim must be overruled. Those matters having been decided, the Court will set for final hearing other pending matters. The Court will refrain at this point from setting a deadline for the Debtors to amend their Plan because resolution of the other pending matters may require further amendment.

Considering the illogical reasoning of the *Terry* line of cases, and the failure of the Courts to adhere to plain meaning of the statutes, it is not surprising that section 1322(b)(2) is being victimized by the bifurcation of home mortgages into secured and unsecured claims in order that the Debtor in a chapter 13 plan may pay all of the secured claim and write off the unsecured claim at cents on the dollar. We recognize this issue is not directly involved in this matter, but it is going to be presented at some time in the future such that comment is apt as a guide to the lower courts. For courts allowing bifurcation of home mortgages, *see In re Cardinale*, 1992 WL 166025 (Bankr. D. R.I. 1992); *In re Sainz-Dean*, 139 B.R. 739 (Bankr. D. Colo. 1992); *In re Hart*, 923 F.2d 1410 (10th Cir. 1991). *Hart* boldly holds "bifurcation is not, of itself, a 'modification' of the secured claim made impermissible by section 1322(b)(2). Indeed, the act of bifurcation recognizes, but

does not affect, the secured claim." *Hart* follows the Third and Ninth Circuits. *Contra, Matter of Nobleman*, 968 F.2d 483 (5th Cir. 1992). *Nobleman* is pending review by this Court at the time of the preparation of this brief. That case presents a cogent and rational examination of the interplay of § 506(a) and § 1322(b)(2) whereas this action involves the interplay of § 1322(b)(2) with § 506(b). Nobleman is supported by the First, Sixth, Seventh, Eighth, and Eleventh circuits.

Nobleman followed the general rule of statutory construction that a specific statute prevails over one of general application. *See Gozlon-Peretz v. United States*, __ U.S. __, 111 S. Ct. 840 (1991). *Nobleman* concluded that § 1322(b)(2) prevented bifurcation "even if the entirety of such a claim is not a secured claim (as per section 506(a)), the rights of a holder of such a claim may not be modified under section 1322(b)(2)." 968 F.2d at 488. *Nobleman* opined that its decision was in accord with legislative history which indicated Congress intended ". . . to afford some protection to the home mortgage industry." 968 F.2d at 489.

IV.

IN ABSENCE OF CONTRACTUAL PROVISIONS, OKLAHOMA LAW PROVIDES FOR INTEREST.

By constitutional provision, ". . . in contracts where no rate of interest is agreed upon, the rate shall not exceed six percent (6%) per annum." Okla. Const. Art. 14, § 2. By statute, ". . . any person who is entitled to recover damages certain, or capable of being made certain by calculation, and the right to recover which is vested in him upon a particular day, is entitled also to recover interest thereon from that day, except during such time as the debtor is prevented by law, or by the act of the creditor from paying the debt." 23 Okla. Stat. § 6 (1991). This statute provides for this interest upon liquidated damages as distinguished from unliquidated damages. *Champlin Refinery Co. v. Phillips*

Petroleum Co., 269 F.2d 993 (1954). By statute, in absence of a contractual provision, the amount of interest applied to a liquidated judgment amount is a rate equal to the average United States Treasury Bill rate plus four percentage points. 12 Okla. Stat. § 727 (1991).

There is nothing in the pertinent sections of the Bankruptcy Code that leaves such a determination of right to present value of money as interest to applicable state law. We contend this issue is preempted by federal law and one determined by reference to the applicable Code sections. Further, the amount of interest to be applied to the arrearages was never an issue in the case at bar.

The Petitioners have raised the issue that 14A Okla. Stat. §§ 1-203 and 3-107 (1991) are in some way applicable to this case. Nothing could be more erroneous, The Oklahoma Consumer Credit Code has as its essential application what is termed "consumer credit sales." The article cited by Petitioner applies only to "consumer loans." Title 14A Okla. Stat. § 2-104(2)(b) defines the exclusion of the Act by defining "consumer credit sales" as follows:

> Unless the sale is made subject to this act by agreement (Section 2-601), "consumer credit sale" does not include
>
> (b) except as provided with respect to disclosure (Section 2-301) and debtor's remedies (Section 5-201), a sale of an interest in land if the credit service charge does not exceed thirteen percent (13%) per year calculated according to the actuarial method on the unpaid balances of the amount financed on the assumption that the debt will be paid according to the agreed terms and will not be paid before the end of the agreed term

Under the article dealing with loans, 14A Okla. Stat. § 3-102 (1991) provides:

> This article applies to "consumer loans" including supervised loans.

Title 14A Okla. Stat. § 3-105 (1991) tracks the language of 2-104(2)(b) by exclusion as follows:

> Definition: "Loan primarily secured by an interest in land"
>
> Unless the loan is made subject to this act by agreement (Section 3-601), and except as provided with respect to disclosure (Section 3-301) and debtor's remedies (Section 5-201), "consumer loan" does not include a "loan secured primarily secured by an interest in land", if at the time the loan is made the value of this collateral is substantial in relation to the amount of the loan, and the loan finance charge does not exceed thirteen percent (13%) per year calculated according to the actuarial method on the unpaid balances of the principal on the assumption that the debt will be paid according to the agreed terms and will not be paid before the end of the agreed term.

The Court will observe the notes and mortgages forming the basis of Respondent's claims had their origin from Jim Walter Homes, Inc. That corporation is the builder of homes varying in stages of construction from shell homes to fully completed homes. The finance charge involved in each transaction was ten percent (10%). In a case involving identical contentions as here, that the paper and the transactions came under the terms of the Oklahoma

Consumer Credit Code, it was contended the transactions involved were sales of goods. The Tenth Circuit disagreed in *Circle v. Jim Walter Homes, Inc.*, 654 F.2d 688 (10th Cir. 1981) by holding the transactions were excluded from the Oklahoma Consumer Credit Code; that the transactions were sales of an interest in land where the finance charge was less than the percentage limitation, and quoted the official comment to the Act as follows:

> Additionally, the official comment on section 104 explains that the ten percent exclusion was intended to exclude from coverage home mortgages, while retaining UCCC coverage of the high rate, "small loan" type of real estate loan. Thus, the framers appear to have chosen the ten percent interest line as a practical division point to differentiate between the two types of transactions as applied to home building or purchase.[2]

It becomes painfully evident that much of Petitioners' reliance on state law application has now "Gone with the Wind."

Clearly, the provision in the note for a late charge applies only to the tardiness of a single installment and is not intended to compensate the mortgagee for the forbearance of large defaulted sums paid over a thirty-six or sixty month chapter 13 plan. Before the matter of time value was ever pressed by this Respondent, we asserted our contractual right to include the late charges in plan payments, and that assertion was a bloody battle finally settled by a District Court opinion which the Bankruptcy Court of the district refuses to adhere to, taking the position that opinions of the District Courts are not binding on the Bankruptcy Courts.

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2. At the time *Circle* was decided, the percentage definitional break was 10% rather than the current 13%.

CONCLUSION

By those courts which have correctly construed the congressional intent through the "compromise amendment" to § 1322(b)(2) to protect the home mortgage industry, it has been generally agreed that such protection was in recognition that the home mortgage lender industry is performing a valuable social service through their loans.

Admittedly, not allowing interest upon the arrearages in a chapter 13 plan is not as onerous as bifurcating and cram down, but still the amount of money lost to the lender by denying such a valuable claim is substantial, considering the increasing number of chapter 13 filings which more often than not include defaulted mortgages. The questions of bifurcation as well as interest upon arrearages is looming as a more important consideration to our national economy when judged in the context of increasing layoffs, the restructuring of our industrial base, and other factors which affect local economies.

If the American Dream of home ownership is to be realized in the future, the engine that drives that dream, the home lending industry, must be able to gauge their risk of loss by factors other than by defaulting loans leading to foreclosure. Where many banks and mortgage bankers as well as govemmental loan agencies are requiring no more than 20% as down payment for the purchase of a home, if the specter of modification of the mortgage claim is a consideration to be factored into the amount of loan to advance, one would be foolish to advance much money to finance a home only to be faced with bifurcation as the loan diminishes down by payment. As well, the amount of interest to be charged for the loan must also be measured by the risk of tying up large sums over a five year period of a Chapter 13 plan after a default. The usual scenario surrounding a mortgage default is the Debtor becomes several months in default, necessitating the last ditch effort on the part of

the lender to file foreclosure. Attorney fees, abstract fees, court costs, advances for insurance and taxes by the lender are incurred. It is usually on the day before sheriff's sale that a chapter 13 proceeding is filed. The claim of the lender includes these amounts as well as the mortgage balance. To deny the time value of these large defaults is a severe burden upon mortgage lenders.

The problem now is severe and will become more-so in the years to come. The chief economist for Federal National Mortgage Association, David Berson, is predicting a nine percent increase in homes sold for 1993, totaling 4.4 million homes sold. He sees a 7 percent rise in single-family housing starts next year. The home lending industry must be protected from the assaults upon their security and bargains if this economic engine is to meet the challenges and demands of the marketplace.

Therefore, those decisions of the Circuits and lower courts which have misconstrued the plain language of the statues must be reversed.

We ask the Court to affirm the decision of the Tenth Circuit.

Respectfully submitted,

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